

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Alternative Investments – Scope of Study
For Private Equity Investment in Underserved
Urban and Rural Communities

ITEM NUMBER: 9

ATTACHMENT(S): 1

ACTION: X

DATE OF MEETING: October 11, 2000

INFORMATION: _____

PRESENTER(S): Mr. Desrochers

One of the 2000/01 Alternative Investment objectives is for staff to explore the feasibility and potential benefits of private equity investments in under served urban and rural communities. At the September 6, 2000 meeting, the Investment Committee directed Staff and Pathway Capital Management to work with an independent consultant to prepare a study to fulfill this objective. As a result of that discussion, Staff and Pathway Capital Management have prepared a proposed draft of the scope of such a study, which is presented for the Committee's consideration as Attachment 1.

Staff and Pathway Capital Management recommend approval of the attached project scope.

ALTERNATIVE INVESTMENTS OBJECTIVES:

EXPLORE THE FEASIBILITY AND POTENTIAL BENEFITS OF PRIVATE EQUITY INVESTMENTS IN UNDERSERVED URBAN AND RURAL COMMUNITIES

Task	Responsibility	Due Date
I BENEFITS Study the possible universe of private equity investment opportunities serving underserved urban and rural communities within California and the merits of such investing. What types of financing are required? (i.e. private equity, mezzanine debt, or debt?)	Consultant	
II RISKS AND RISK ADJUSTED RETURNS <ul style="list-style-type: none"> ➤ What are the uniqueness and differences in these markets. Why are they not actively pursued by institutional investors, including public pension funds? ➤ Can a large public pension fund find an attractive private equity niche in urban and rural environments with a reasonable risk/reward ratio? 	Consultant	
III PRIVATE EQUITY INVESTMENTS HAVE THE FOLLOWING CHARACTERISTICS <ul style="list-style-type: none"> ➤ Can a large public pension fund expect to find some or all of these characteristics in urban and rural private equity investing? <ul style="list-style-type: none"> ◆ Scalability – the investment must be able to grow at significant growth rates to generate economies of scale, barriers to easy competition, and high valuations. ◆ Liquidity – the investments must be in sectors and have growth features that make them marketable to strategic or other financial buyers so that CalSTRS can exit them. ◆ Profitability – these investments should be able to generate returns of 25%+ after carry. ◆ Capitalization – successful investments should have capitalizations in the \$300 million range to create the economic efficiencies of successful investments. 	Consultant	
IV. PRIVATE EQUITY IN URBAN ENVIRONMENT <ul style="list-style-type: none"> ➤ What are the unique opportunities within the urban and rural underserved markets? <ul style="list-style-type: none"> ◆ How large is the investment market opportunity within California? ◆ How are companies in the underserved markets currently funded, in terms of both equity and debt? Who provides the funding? What are the expected returns for both the equity and debt funding sources? ◆ In terms of capitalization, how large are the companies that could receive investment from a CalSTRS funded investment vehicle? Provide detail as to the number of companies at different capitalization sizes in the universe of possible investment opportunities. ◆ What is the failure rate of companies in the underserved urban and rural markets, and how does it compare to other markets? Would this rate change with additional capital availability? ◆ Would the products and services be used in these communities? Would the products and services be exported to other parts of California, other states, or outside the U.S.? ◆ What kinds of business sectors make good private equity investments, and which sectors stand little chance of success? 	Consultant	

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V. PARTICIPANTS IN THE PRIVATE EQUITY URBAN AND RURAL INVESTING <ul style="list-style-type: none"> ➤ What other large institutional investors, including public pension funds, are investing in these markets? If no significant investing, why not? ➤ Description of current programs ➤ What are their performance track records and experiences in these markets? ➤ What strategies and business models have been successful? Can they be replicated? 	Consultant	
VI. CALSTRS INVESTMENT OPTIONS <ul style="list-style-type: none"> ➤ What are the unique opportunities and risks with each of the following options? <ul style="list-style-type: none"> ◆ Partnerships ◆ Co-investments ◆ Direct Investments ◆ Other 	Pathway	
VII. RECOMMENDATIONS	Staff/Pathway	